

## Veto No. 2005-1

HB 515

December 23, 2005

To the Honorable, the House of Representatives  
of the Commonwealth of Pennsylvania:

I am returning herewith, without my approval, House Bill 515 entitled "An Act amending the act of March 4, 1971 (P.L.6, No.2), entitled 'An act relating to tax reform and State taxation by codifying and enumerating certain subjects of taxation and imposing taxes thereon; providing procedures for the payment, collection, administration and enforcement thereof; providing for tax credits in certain cases; conferring powers and imposing duties upon the Department of Revenue, certain employers, fiduciaries, individuals, persons, corporations and other entities; prescribing crimes, offenses and penalties,' further providing, in sales and use tax, for the definition of "manufacture"; and further providing, in personal income tax, for imposition and, in corporate net income, for definitions."

House Bill 515 would result in a loss to the General Fund of:

\$ 53.1 million in 2006-2007  
\$163.4 million in 2007-2008  
\$212.5 million in 2008-2009  
\$286.7 million in 2009-2010  
\$387.8 million in 2010-2011

If this legislation were to become law, the Commonwealth budget would suffer the loss of over \$1 billion in revenue in the next five years and that number would continue to grow. More troubling is that House Bill 515 is not coupled with any legislation that identifies cuts in expenditures deemed by the legislature to be appropriate reductions in government activities or services sufficient to compensate for this lost revenue. In fact, to balance the impact of this loss in revenue in the out years, cuts such as the total elimination of state appropriations for the Head Start program, for early childhood education and for libraries would only begin to bring the budget into balance.

On November 30, 2004, when I vetoed House Bill 176, I wrote: "I intend to enforce a 'pay as you go' budget process for Pennsylvania. I will not sign legislation that either significantly increases spending or reduces revenue without a specific plan to pay for it." A tax bill that will cost over \$1 billion in revenue over the next five years should be debated and negotiated during the annual budget process and the passage of the Commonwealth's budget. What I said then still holds true today. As long as I am Governor, I will not sign legislation that materially reduces Commonwealth revenue unless I am also presented with a viable plan to pay for that legislation.

In areas where the budget can sustain business tax decreases, I will work to support them. I have demonstrated my commitment to reducing business taxes by continuing to phase out the Capital Stock and Franchise Tax (CSFT). In FY 05-06 the CSFT phaseout will provide a net benefit to businesses

of \$163.1 million. Over the next five years, the phaseout will generate cumulative business tax savings of nearly \$2.9 billion. Next year's reduction in the CSFT will bring the rate to 4.99 mills, the lowest rate since 1890. In addition, in 2003 I signed Act 46, which doubled the size of the research and development tax credit in Pennsylvania – moving from a total of \$15 million to \$30 million in research and development tax credits statewide.

Pennsylvania businesses are paying business taxes at a higher tax rate than necessary because so many of our companies are not required to pay direct business taxes. Today, 73 percent of all businesses subject to the Corporate Net Income (CNI) tax report zero tax liability. The fact that so many businesses do not pay their fair share of the state corporate tax burden drives up the CNI tax rate for those businesses that have a tax liability and pay their taxes.

Because Pennsylvania's business tax rates are high and our methods of taxation are not fair to all businesses, I formed the Pennsylvania Business Tax Reform Commission. Republican and Democratic leaders in the General Assembly each appointed representatives to serve on the 12-person commission, which also included representatives from the Chamber of Commerce and the Pennsylvania Business Roundtable. Appointees to the Business Tax Reform Commission came from major Pennsylvania corporations and also included business tax practitioners. All 12 members of the Commission, including those appointed by business and legislative leaders, studied our system of business taxation and crafted a plan that was unanimously endorsed as a true business tax reform package. This package reduced the CNI tax rate, totally uncapped the net operating loss carry forward (NOLs), moved to a 100 percent sales factor for CNI tax apportionment and closed business tax loopholes through combined reporting.

In the budget that I submitted to the legislature earlier this year, I went beyond the business tax rate reductions in House Bill 515 by proposing that we cut our Corporate Net Income Tax to 7.9 percent and implement other Tax Reform Commission recommended changes, including the uncapping of Net Operating Losses. For many Pennsylvania businesses, House Bill 515 does not come anywhere close to providing the level of business tax reductions I proposed, and the proposals contained in House Bill 515 do not offer the comprehensive changes sought by the business community. Moreover, House Bill 515 does not close a single business tax loophole.

If the principles embodied in House Bill 515 were presented to me in the context of legislation to enact the recommendations of the Business Tax Reform Commission, or in the context of a Commonwealth budget that makes the necessary expenditure reductions needed to support the tax cuts, I would enthusiastically engage in the policy debate over that legislation and would work to make Pennsylvania's tax structure more business friendly. In particular, uncapping Net Operating Losses and adjusting the single sales factor to help Pennsylvania manufacturers are laudable goals. But we cannot achieve these goals without finding a way to pay for them.

For the reasons set forth above, I am withholding my signature from House Bill 515. I urge the General Assembly to work with me to develop and

pass fiscally responsible legislation that will create a fairer, more competitive Pennsylvania business tax system.

EDWARD G. RENDELL